Commonwealth of Massachusetts
Department of Telecommunications and Energy

Investigation into the Provision of Default Service	**)**	**D.T.E. 02-40**

Initial Comments of the
Massachusetts Technology Collaborative

I. Introduction

These comments are submitted by the Massachusetts Technology Collaborative ("MTC"), in response to the Department of Telecommunications and Energy's ("Department", or "DTE") June 21, 2002 request for comments with respect to its Investigation into the Provision of Default Service.

The Massachusetts Technology Collaborative, a public instrumentality established pursuant to M.G.L. Chapter 40J, is an independent economic development organization whose purpose is to promote sustainable economic growth by supporting regional technology-based clusters and by serving as a public policy laboratory for technology-related initiatives.

MTC administers the Renewable Energy Trust Fund, created by the state legislature as part of the Electric Utility Restructuring Act of 1997, to help the Commonwealth shift toward greater reliance on renewable energy resources to meet its needs and to spur development of the renewables sector as an important source of economic growth in Massachusetts.

To further that legislative mandate, the MTC has established four specific objectives:

- Shift electric energy consumption in Massachusetts away from conventional energy resources to a greater reliance on energy generated from renewable resources;
- Increase electric generating capacity from renewable resources to meet the growing energy demands of consumers in Massachusetts while also encouraging the adoption of energy efficiency measures;
- Expand and support the renewable energy sector in Massachusetts, including system developers, system integrators, manufacturers, equipment vendors, architects and engineers, service providers, and research organizations; and
- Increase the overall level of economic activity related to renewable energy in the Commonwealth.

The outcome of this proceeding will have a direct and substantial effect on the MTC's ability to accomplish its objectives. Both the supply of and demand for renewable resources will be affected by the Department's decisions regarding the design of default service.

II. The Relationship between Default Service Reform and Renewable Energy

The outcome of this proceeding is critical to the development of renewable energy in Massachusetts. Moreover, having a supply of and market for renewable energy is critical to the Department's realization of its goals for default service reform.

A. The Design of default service affects the supply of and demand for renewable energy.

Renewable energy development is driven by two forces: 1) the Renewable Portfolio Standard; and 2) customer choice of green power products in the competitive market. Both of these forces are at stake in this proceeding.

Renewable Portfolio Standard.

The Renewable Portfolio Standard ("RPS") requires all Retail Electricity Suppliers to include a minimum percentage of renewable generation in their electricity sales to end-use customers in Massachusetts. M.G.L. c. 25A, § 11F; 225 CMR 14.00. Default Service and Standard Offer (which converts to Default Service in 2005) account for 78% of MWh sales,[1] and thus account for 78% of the RPS obligation. Therefore, the Department's decisions in this proceeding will determine which entities will provide Default Service, and how those entities will fulfill their RPS obligations. The manner in which default service providers comply with RPS will have an enormous impact on whether the RPS succeeds or fails.

Competitive Green Power Market.

The second driver of renewable energy development is customer choice of green power products in the competitive retail market. Customers willing to pay a premium to buy green power will spur the development of new renewable energy generation to meet that demand.

[1] Davison of Energy Resources, Electric Customer Migration Data (May 2002), www. state.ma.us/doer.

The Department's decisions regarding default service design will determine whether a competitive retail market develops to offer customers that choice. As the Department has pointed out, "[b]y its very nature as a generation service of last resort, the manner in which default service is made available to consumers could significantly affect the development of the competitive market." Investigation into the Provision of Default Service, D.T.E. 02-40, p. 1 (June 21, 2002). Unless the Department reforms default service either to create a competitive retail market for all customer classes, or to create a green product choice within default service, there will be no customer choice to drive renewable project development.

B. The availability of renewable energy is central to the Department's realization of its goals.

While this proceeding is important to renewable energy, so too renewable energy is important to the Department's realization of its goals in this proceeding.

As the Department explained in its Order opening this investigation, it is looking to "ensure that the benefits of a competitive market are available to **all** Massachusetts consumers at the end of the standard offer service transition period." Default Service, p. 2 (emphasis added). Residential customers pose the greatest challenge. In the large customer markets, competitive suppliers have used price reductions to drive customer switching and market development. However, given residential customers' low average usage, it is unlikely that price discounts will drive the market for those customers. For example, NSTAR reports

that 400,000 of its residential customers have an energy bill of less than $18 per month.[2] For these customers, a 5% discount would produce savings of less than $1.

By contrast, a green product would be seen as valuable by residential customers, and could drive customer choice and market development. A statewide public opinion research survey conducted by MTC in February 2002 found that there is overwhelming support (90%) for increasing the use of renewable energy and more than half of all Massachusetts consumers are willing to pay extra for renewable energy. Fifty-seven percent of those who indicated they would pay more said they would be willing to pay $10 or more extra each month if all of their electricity was produced from renewable energy.[3]

Thus, the availability of renewable energy will help the Department realize its objective of brining the benefits of the competitive market to all customers.

III. The Department should Modify the Default Service Rules to Enable the Success of the Renewable Portfolio Standard.

A. The success of the RPS is dependent upon the availability of creditworthy entities that are willing and able to enter into long-term purchase agreements with renewable energy generators.

The purpose of the RPS is to foster the development of new, renewable generation. The minimum percentage of new renewable generation required by

[2] Horan, Douglas, *Restructuring Phase II: The Development of Customer Oriented Competitive Markets*, presentation to Massachusetts Electric Restructuring Roundtable (June 21, 2002)
[3] Massachusetts Technology Collaborative, *Opinion Research Survey: Executive Summary,* www.masstech.org/massrenew/green_power/cons_agg/summary.htm (March 13, 2002)

the RPS increases over time.[4] There is not sufficient new renewable generation in place today to meet that increasing requirement. **Thus, new generation must be built for the RPS to be met.**

Developers of renewable generation report that new generation will not be built unless developers are able to obtain long-term purchase agreements either for renewable generation certificates or for certificates and supply. These contracts will be necessary for the developers to obtain construction financing.

It is true that there are several significant wind energy projects that are in the early stages of development in New England, even without the availability of long-term contracts from Massachusetts default service providers. However, there are substantial differences between early development activities and construction. The long-term contracts are needed to support construction financing. Those projects have not yet reached that stage.

It is also true that gas combined cycle projects can be financed on a merchant basis, i.e. without long-term contracts. However, Renewable energy projects face hurdles in financing that fossil fuel projects do not. Renewable energy projects have higher upfront capital costs and lower operating costs when compared to fossil fuel fired plants. Because of this cost structure, longer contract commitments – 10 to 20 years – for the purchase of energy, renewable attributes, or both attributes and energy are a critical driver to development of new renewable energy plants.

[4] The minimum percentage increases from 1% in 2003 to 4% in 2009. The Division of Energy Resources has the authority to increase the percentage by 1% per year thereafter. 225 CMR 14.08.

B. The current Default Service rules have created a barrier to the success of the RPS.

The current default service rules are creating a barrier to the success of the RPS. Under the current rules, the utilities, which are the default service providers and have 78% of the RPS obligation, are unwilling to enter into long-term contracts that are necessary for renewable energy projects to be built. There are several reasons.

Prohibition on long-term purchases. First, the Default Service Guidelines direct the utilities to "procure Default Service for a period ranging from a minimum of six months to a maximum of one year." Pricing and Procurement of Default Service, D.T.E. 99-60-B (June 30, 2000). While the Guidelines do not specifically address the certificates required for RPS compliance, it would certainly be possible to interpret the existing Guideline as prohibiting multi-year purchases of certificates as well as multi-year purchases of supply.

Uncertainty regarding long-term obligation. As the Order opening this proceeding makes clear, it is uncertain whether the utilities will continue to have the default service responsibility after February of 2005, or whether the responsibility will be shifted to other entities. With uncertainty regarding the future obligation, the utilities are understandably reluctant to make long-term commitments to procure RPS certificates.

Limited incentives. Finally, the utilities have little or no financial incentive to reduce the costs of Default Service. Default Service costs are a pass

through for the utilities. Accordingly, they have no financial incentive to assume any risk at all to lower their costs and thus the price, for example, by purchasing renewable certificates under long-term contracts at below the cost of the 5-cent/kWh Alternative Compliance Payment penalty.[5]

C. The Department can facilitate the success of the RPS by making utility procurement strategies compatible with the development of new, renewable generation.

There are several steps that the Department can take to make utility default service procurement strategies compatible with the development of new renewable generation.

First, the Department should authorize and encourage the utilities to enter into long-term contracts for RPS certificates or bundled RPS certificates and energy.

Second, the Department should give the utilities certainty regarding the period for which they will be responsible for supplying default service. The Department should make it clear today whether the utilities will exit Default Service, and if so when. If the Department is unable to provide this certainty, it should clarify that utilities will be able to recover the cost of RPS commitments, even if the utility exits the default service function prior to the end of those commitments.

[5] The RPS regulations allow retail suppliers to meet their RPS obligations by making an Alternative Compliance Payment (ACP) to the MTC. 225 CMR 14.09(4). The ACP is designed to protect against RPS compliance cost price spikes. Massachusetts Division of Energy Resources, "Background Document on the Proposed Regulation for the Renewable Energy Portfolio Standard, 225 CMR 14.00," p. 3 (October 2001).

Third, the Department should put the utilities on notice that it will carefully scrutinize their RPS compliance strategies. The Department could, for example, create a utility performance metric regarding RPS compliance, with incentives and penalties for performance. This would align utilities' interests with those of ratepayers and with those of the RPS itself. As long as the utilities are the default service providers, for the RPS to succeed the utilities must be active purchasers of certificates and not passive payers of the ACP.

These reforms will not only result in an increased supply of renewable energy, but will also reduce the costs of RPS compliance, and thus the costs of default service. If sufficient new renewable generation is not build, default service suppliers will have no choice but to pay the ACP of $50 per MWh. However, the ACP was set higher than what would be the market price, assuming that there was a sufficient supply of new renewable generation to meet the demand. Thus, by helping to ensure that there is an adequate supply of new renewables to satisfy the RPS, default service providers will lower their costs.

D. The role of the MTC in RPS compliance.

Some might suggest that the MTC, with the resources from the renewable energy charge and potential revenue from the ACP might be in a position to ensure that new generation is built to meet the RPS. Unfortunately, however, the need greatly exceeds the resources of the MTC. For example, the capital investment required to build 1,000 MW of new wind plants (roughly what would

be required for compliance through 2009) is on the order of $1 billion. It is true that, if all default service suppliers choose to pay the ACP, there could be substantial ACP revenues. However, given the year-to-year uncertainty of that revenue stream, it would be unable to support the long-term commitments that are needed for developers to obtain construction financing.

IV. Green Power Purchasing Options

The competitive retail market should create opportunities for customers to exercise their preferences for green power, and should also create an additional demand for new, renewable generation.

Unfortunately, however, Massachusetts' retail customers have very little ability to exercise this choice today. As the Department has pointed out, the competitive market has not developed for residential customers. Investigation into the Provision of Default Service, D.T.E. 02-40, p. 5 (June 21, 2002). MTC's initiatives to date designed to increase the demand for green power indicate that even large commercial and industrial retail customers who are willing to pay a premium for green power have little ability to exercise this choice.[6] And, the utilities providing Standard Offer and Default Service, the de facto monopoly providers, do not offer a green option.

There are several strategies the Department can take to foster the development of green power choices for customers.

[6] In September 2001, MTC awarded grants to nine Massachusetts' entities for the purpose of increasing consumer demand for green power. The objective of this grant program is to use the collective buying power of an aggregation to ensure that a portion of the electricity purchased is generated from renewable resources. Additional information about the 9 entities and their green power aggregation activities can be found on MTC web page, www.masstech.org.

A. Utility Default Service green power option

If the Department chooses to keep the utility in the role of default service provider, it can foster the development of the green market by requiring utilities to offer a "green" default service option.

This approach is similar to the approach adopted by the state of Oregon. There, residential customers do not have the option of choosing a competitive supplier. However, the utility is required to offer those customers a portfolio of choices, including three renewable options:[7]

- a fixed renewable option, which supports the development of new, renewable generation;
- a usage-based renewable option, under which all of the customer's needs are served by renewable energy; and
- a habitat friendly product, under which funds are contributed to an organization dedicated to the restoration of the habitat of the salmon.

While three green default options may be excessive for Massachusetts, a single green Default Service option would have many benefits.

First, the offering of a green default service product would mean that **all** customers would have a green option. This would be a great benefit for Massachusetts customers, many of whom would like to buy green power but have had no way to do so before now.

Many market observers would prefer to see the competitive market, rather than the utility, offer the green option. However, unless the Department takes very aggressive steps to develop the market, it seems this market will be

[7] ORS 757.603(2); Oregon Public Utilities Commission, Order 01-337 (April 26, 2001).

very slow to develop and it is unlikely that the market will offer a green product to residential customers any time soon.

Second, a green default service option could actually foster the development of the competitive market. It could do so by enabling customers to become accustomed to making choices regarding their electricity service, and to do so within the safety net of utility service.

To further the market development effects of the utility green default service option, it could be offered in partnership with a competitive electricity provider. This is how it is done in Oregon. Two of the green products offered by both Portland General Electric ("PGE") and Pacific Power are offered in partnership with a leading competitive electricity supplier. The product sold by both PGE and Pacific Power is named "Green Mountain Energy Electricity". The supplier of the green product is featured on the utilities' web sites, and also markets the product on its own web site and through the press.

One feature that would increase the degree to which the program enhances the competitive retail market would be to make it temporary, and build in a transition to competitive suppliers. The Default Service green product could be offered for only two years, for example. At the end of that time, the utility could give customers an easy way to switch to competitive suppliers offering similar services, for example, through a check off postcard or through the utility web site. Or, at the end of the term, customers that chose the green option

could switch automatically to a competitive product offered by the supplier that offered the green default product in partnership with the utility.

B. Assignment of Default Service customers to competitive suppliers.

The Department could also foster the development of green product options by removing the utility from the role of default service provider and assigning default service customers to competitive providers through a retail auction approach. This could be expected to lead to green product offers for customers for several reasons.

First, green products have featured prominently in those states that have seen active competitive retail markets for residential customers, such as in both Pennsylvania and Texas.

Second, if the retail auction structure creates an incentive for competitive default service providers to move customers off of default service and on to competitive offerings, those suppliers will have an incentive to develop green competitive offerings to attract customers.

The structure of the retail auction is very important, however. It must be designed to create a speedy transition to a true competitive retail market, and not just create a new, perpetual form of default service. Issues that will be very important include:

- *What happens to customers at the end of the initial default service term? Do they stay with their competitive default service providers or do they fall back into a new default service pool, simply to be auctioned all over again?* If they fall back into a new pool, this mechanism may turn into no more than a different procurement

regime for distribution company default service. It is unlikely to foster a competitive market or the development of a green power competitive offering for these customers.

- *Are the auctions designed for wholesale providers or retail providers?* To promote the development of a green power competitive offering for residential and small commercial customers, the auctions would need to be designed for retail providers.

C. Utility support for green power marketers.

There are steps the Department can take to foster the green power market, regardless of whether it chooses to keep the utility in the default service role or to move competitive suppliers into that role.

For example the Department could require the utilities to provide aggressive marketing assistance to competitive suppliers offering green products. The utilities could highlight such products on their web sites and in bill inserts. They could also give customers an easy way to switch to green products, for example through a return post card or directly through the utility web site. These steps would reduce competitive suppliers' marketing and customer acquisition costs, and help to foster the development of a green power market.

V. Conclusion

The MTC respectfully requests that the Department adopt the foregoing recommendations.

Respectfully submitted,

MASSACHUSETTS TECHNOLOGY COLLABORATIVE

by

/s/
Robert L. Pratt, Director
Renewable Energy Trust
75 North Drive
Westborough, MA 01581
(508) 870-0312

Dated: August 9, 2002